No. 2421

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

ARTHUR H. BRANDT, as trustee of F. S. MAYHEW, in bankruptcy,

Petitioner,

vs.

F. S. MAYHEW, and MRS. F. S. MAYHEW, husband and wife,

Respondents.

In the Matter of F. S. MAYHEW,

In Bankruptcy.

PETITION FOR A REHEARING.

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To the Honorable William B. Gilbert, Presiding Judge, and the Associate Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

The petitioner in the above entitled cause respectfully prays that a rehearing may be had of the decision of this Court denying the petition for revision and affirming the order of the District Court.

This petition is not filed for the purpose of delay, for the petitioner, as trustee, is as desirous as the exemption claimants that the administration of the estate may be closed as expeditiously as possible consistent with a final determination of the rights of all parties involved, but solely for the reason that he is strongly convinced that the decision of the Court on at least two of the important questions decided is untenable on any possible construction of the Bankruptcy Act. We are persuaded that the desire on the part of the majority of the Court to grant the homestead exemption has led them to go far beyond the limits within which such liberality can legally be indulged in.

In demonstrating that the claimants in the present case were not entitled to the homestead exemption claimed, the petitioner in his written briefs and on oral argument contended for the two following fundamental propositions: Firstly, that a bankrupt in the State of California is not entitled to claim a real estate homstead exemption where no declaration of homestead, as required by the state statutes, has been filed prior to the adjudication in bankruptcy; and Secondly, that assuming that he would otherwise be so entitled, he is precluded from subsequently making such a claim by a voluntary conveyance of the real property for the benefit of creditors made prior to the petition and adjudication in bankruptcy.

In support of the first of these two main contentions, the petitioner argued (a) that the bank-

rupt could not make such claim under the general homestead law of the State of California set out as Title V, Part IV of the Civil Code (under which, in fact, he did claim), because neither he nor any one in his behalf had taken the necessary statutory steps to create the homestead prior to adjudication; (b) that he could not claim such homestead exemption under Paragraph 64 of Art. X of the Insolvent Act of 1895 of the State of California, because that Act was suspended by the National Bankruptcy Act, and was neither "an exemption" nor "a law in force" such as contemplated therein; and (c) that even if the bankrupt could claim under either of these two sets of statutes prior to 1910, he was effectively precluded from so doing by the application of Section 47A(2) of the Bankruptcy Act as amended in that year. The Court having held adversely to the contention of petitioner on the first of these questions (a) did not discuss whether the right could be claimed under the Insolvent Act (b), evidently considering that the determination of that question was not necessary for the decision. With reference to the third contention of petitioner (c), while we think there was and is considerable merit in petitioner's contention that Section 47A(2) as amended in 1910 must be given the effect required by its express terms, we fully appreciate the force of the Court's statement that it was passed for a particular purpose, and that this purpose is to be taken in consideration in its construction and application. We

very earnestly urge, however, that neither the letter nor the spirit of the Bankruptcy Act supports the conclusion of the Court on the two more fundamental questions involved.

I.

The Court holds that a bankrupt in the State of California has a right to a homestead exemption to the extent of $5000.00 out of real property occupied by himself and his family, even though no declaration of homestead has been filed by him or by any one on his behalf prior to his adjudication as a bankrupt; and that irrespective of the bankrupt's right in the premises, his wife is entitled to file such declaration subsequent to adjudication, and claim the exemption.

We have experienced considerable difficulty in ascertaining the exact grounds upon which the Court bases its holding that the bankrupt, under these circumstances, is not precluded from claiming his exemption. From a careful reading of the opinion it would appear that the Court reached its conclusion on the theory that the mere procedural principle "that the Bankruptcy Act is controlling as to the time and manner of claiming exemptions", in some manner excused compliance with the state law prior to adjudication. That this is so seems to be shown by the following language of the Court:

> "While exemptions allowed a bankrupt are fixed and defined by the law of the state of his domicile, *the Bankruptcy Act is controlling as*

to the time and manner of claiming, selecting and allowing exemptions, and the courts have given these provisions of the Act a liberal and equitable construction. In Smith v. Thompson, 213 Fed. 335, Judge Hook said: 'In every court the administration of an exemption law should comport with the beneficent spirit that prompted its enactment. A court of equity especially should not attempt to defeat the exemption by niceties in practice. It should be helpful to those whose condition requires them to invoke it.' The contention of the trustee is based upon the language of Section 70a, which provides that the trustee shall be vested by operation of law with the title of the bankrupt's property except as to property which is exempt, which provision, it is said, shows the intention of the law to be that property, in order to be excepted, must be recognizable as exempt at the date of the adjudication. *But Section 70a does not deal with the time or manner of claiming exemptions. Those matters are regulated by other provisions.* Section 7, cl. 8, gives to the involuntary bankrupt, the right to claim his exemptions within ten days after the adjudication, and the time within which he may do so may be further extended by amendment, as authorized by General Order XI. * * *

"But it is urged that the bankrupt in this case did not claim his homestead until after his right to claim it as exempt under the bankruptcy law had expired, in that, although he was adjudged a bankrupt on February 8, 1912, he did not claim the exemption until February 17, 1913. But it appears from the record that the bankrupt did not file his schedules until the date last mentioned, and that in his schedules, as he was permitted by law to do, he made his claim of exemption of a homestead. The reason for the delay in filing the schedules is

> not explained in the record. No question is made, however, of the bankrupt's right to file them on the date mentioned. We may assume that the Referee, upon good cause shown, permitted them to be filed of that date."

There is no controversy as to the rule "that the time and manner of claiming exemptions are controlled by the provisions of the Bankruptcy Act", and the petitioner has at no time questioned this principle. Nor has the petitioner at any time made any point on the fact that the bankrupt did not file his schedules or make his claim within the time stipulated in the Act. On the contrary, in Petitioner's Reply Brief (pages 1 and 2) he expressly states that "the trustee has made no point on the delay of the bankrupt in claiming his exemptions in bankruptcy provided that he is otherwise entitled to them".

We think that the Court has confused the question of *procedure* for claiming an exemption in the bankruptcy proceedings with the question of the *substantive right* to the exemption. Obviously, to entitle a bankrupt to an exemption two things must concur: First, *the right* to the exemption must be accorded by the state law, and; Secondly, the exemption must be claimed by the bankrupt in the bankruptcy proceedings at the time and in the manner prescribed by the bankruptcy law. Though both of these facts must exist before the exemption right can be successfully claimed, it is obvious that as pre-requisites to the assertion of such claimed

right they are distinct. The mere fact, for example, that a bankrupt has made claim to an exemption at the time and in the manner prescribed by the Bankruptcy Act does not in itself entitle him to the exemption *unless the fundamental right, irrespective of the time and manner of claiming it, is accorded by the state law.*

> "*The mere act* of a bankrupt *in claiming* a homestead exemption in the schedule filed by him is not a compliance with Code Va. Sec. 3631, providing that in order to secure the benefit of the exemption of real estate, the homesteader shall, by a writing filed by him and duly submitted to record to be recorded as deeds are recorded, declare his intention to claim such benefit and select and set apart the real estate to be held by him as exempt."
>
> In re Garner, 115 Fed. 200.

> "That a bankrupt's right to an exemption must be deduced from the state law is unquestionable; but it is no less true that, *where the right exists,* it is to be asserted in the manner which the Bankruptcy Act itself prescribes."
>
> Lipman v. Stein, 134 Fed. 235.

> "The exemptions provided by the law of the state are allowed by the Bankruptcy Act, but the manner of claiming such exemptions and of setting apart and awarding them is regulated by the Bankruptcy Act."
>
> In re Kane, 127 Fed. 552.

The principle that an exemption must be claimed at the time and in the manner prescribed by the Bankruptcy Act is a rule relating merely to the

procedure requisite to assert the right in bankruptcy proceedings, and, necessarily, presupposes the existence of that right.

The petitioner has always assumed for the purpose of the discussion of this case that the bankrupt did claim the homestead in the bankruptcy proceedings at the time and in the manner provided for by the Bankruptcy Act, viz: that in asserting his claim he followed the procedure prescribed by the Act. The fundamental question, however, is: *Did the bankrupt at the point of time when such right must exist, have a substantive right to the exemption under the laws of the state?* This question can be answered only by a determination of the exact time when such right must exist to be availed of in bankruptcy and by a determination of the nature of the right accorded by the state law.

It is so well established that the date of the adjudication in bankruptcy is the "line of cleavage" and fixes the status of all property, including exemptions, that we never conceived there could be any controversy about the fact until a contrary suggestion was made by the Court in this case. Mr. Remington, in his work on bankruptcy, thus states the principle:

> "The date of the adjudication in bankruptcy fixes the status as to exemptions. If the bankrupt then was entitled to the exemptions he claimed, the property remains his property free from the claims of creditors, notwithstanding he may no longer be entitled to exemptions at the time the trustee is ready to set apart

> exempt property. The date of adjudication is the line of cleavage. That date severs his old estate from his new estate; his old creditors from his new ones. Since the exempt property is taken away from the old estate, and the last moment of the growth or life of the old estate is the moment the debtor is adjudged a bankrupt, it follows that that moment is the moment which fixes the status of the property."
>
> Vol. I, Sec. 1025, page 575.

This principle necessarily follows from the express provisions of Section 70a of the Bankruptcy Act, and has never so far as we have been able to ascertain, been seriously questioned. In the case of In re Mayer, 108 Fed. 599, the Circuit Court of Appeals for the Seventh Circuit said:

> "The intention of this statute, is, without doubt, that the creditors shall have all of the estate of a bankrupt which is not exempt, and that the bankrupt shall the exemptions allowed by the law of his domicile *determined by relation to the date of adjudication.*"

The only question in the mind of the Circuit Court of Appeals for the Eighth Circuit in the case of In re Youngstrom, 153 Fed. 97, was whether the "line of cleavage" was the date of filing the petition or the date of adjudication. That the status of the property could be affected by any means after the latter date, was not even suggested as a possibility.

> "Indeed, we think the statute admits of doubt only in respect of whether the right to any claimed exemption is to be determined as of the time of the filing of the petition, or as

> of the time when the debtor was adjudicated a bankrupt. That it is to be determined as of the earlier date as suggested by those provisions of Sec. 6, Sec. 7, cl. 8, and Sec. 70a, cl. 5, which make the time of the filing of the petition of special significance, and that it is to be determined of the latter date is suggested by the provision in Sec. 70a that the trustee shall be vested with the title of the bankrupt as of the date he was adjudged a bankrupt."

It must be taken, therefore, as settled beyond all controversy, that irrespective of the mere time or manner of claiming it in bankruptcy, the exemption, if it is to be successfully asserted, must have existed at the date of adjudication. If this be true, it is absolutely impossible to conceive how a bankrupt is entitled to a homestead exemption where, at the date of adjudication no such homestead and no such right existed. To say that he can take the necessary statutory steps after adjudication, and by so doing claim his exemption, is not, as suggested by the Court, merely permitting him to "perfect" his exemption, but is giving him a right to *create* an exemption that did not in any possible view of the case exist at the date of adjudication.

If the homestead right here involved was a general right not dependent upon compliance with any statutory pre-requisites, the position of the Court would undoubtedly be correct. In such a case, the exemption would necessarily have existed at the date of adjudication. In the present case,

however, and this is the all important and determining factor, *there was no homestead, and, consequently, no possible exemption at the date of adjudication.* The right in the State of California is not a general one to be availed of at any time, but is only one that can be availed of when it has been created as provided by the statutes. Section 1262 of the Civil Code provides that in order to select a homestead a declaration of homestead must be executed, acknowledged and recorded in the same manner as a grant of real property. Section 1265 provides that,

> "*from and after* the time the declaration is filed for record the premises therein described constitute a homestead."

In view of these provisions of the state statutes only one conclusion is possible: at the date of adjudication no declaration of homestead having been filed, there was no homestead, and consequently no exemption right on the part of the bankrupt.

The argument of the majority in their opinion is in effect this:

> "The time and manner of claiming exemptions is controlled by the provision of the Bankruptcy Act, *therefore,* no declaration of homestead need be filed prior to adjudication."

From what has been said it is apparent that these two propositions are wholly unrelated, and that the conclusion is an absolute "non sequitur".

The opinion of the Circuit Court of Appeals for the Eighth Circuit, in the case of In re Young-

strom, written by Judge Van Devanter, now an associate justice of the Supreme Court, from which extracts are quoted at length in the dissenting opinion, and which has been entirely ignored by the majority of this Court, settles this identical question beyond all controversy. We submit that if there is any distinction between that case and the case at bar on this branch of the case, it should be pointed out by the Court. Or, if the majority of this Court believes that decision to be erroneous, the reasons for such belief should be stated. The present decision instead of settling the question on the only basis permissible under the Bankruptcy Act, has, by accepting the ill-considered and untenable position of one or two District Courts, thrown the whole matter into confusion.

The Court further suggests that irrespective of the bankrupt's rights in the premises, Mrs. Mayhew, the wife, is in any event entitled to claim the exemption. What has just been said we think effectively answers this suggestion. The property stood in the name of the bankrupt and was his own separate property. As such it became one of the assets of the bankruptcy estate. Undoubtedly, Mrs. Mayhew, under the state statutes, could have filed a declaration of homestead on the property prior to adjudication, and by so doing have created the exemption right in the bankrupt. But we know of no case that permits a wife to claim an exemption on behalf of the bankrupt where that exemption did not, either by reason of his act or her act, exist

prior to the date of adjudication. The case of In re Maxson, 170 Fed. 356, does not support the Court's position in this regard. In the first place, the Court in that case held that the bankrupt had virtually amended her petition and thereby had, as a matter of fact, claimed her exemption, irrespective of the claim of the husband. In the second place, the homestead right involved in that action was *a general right* and not one depending upon the performance of any statutory pre-requisites. Accordingly, the right, without question, existed at the date of adjudication. For this reason the case, while undoubtedly correct on the facts, is not in point.

II.

The Court holds further that the conveyance made by the bankrupt and his wife to Willard O. Wayman prior to the petition and adjudication in bankruptcy as part of a general assignment for the benefit of creditors, did not preclude them from making the subsequent claim to the exemption.

If we understand the decision of the Court aright, this conclusion was reached on the theory that since the conveyance was not made in fraud of creditors or as a preference, there was no equitable reason why they should be denied the right. If the mere *motive* that actuates the bankrupt in the conveyance is to be considered the determining factor, no good reason appears why the Court

should aid him in repudiating the voluntary subjection of his exempt property to the claims of his creditors. If he has deliberately and advisedly, in recognition of his moral obligations, turned over property which he might otherwise hold as exempt, for the benefit of his creditors, he should be required, on the plainest principles of equity, to abide by his voluntary act. We conceive, however, that the determining question is not one of "motive", but essentially and entirely one relating to the status of the title.

That the question may be definitely and clearly presented, we will assume, for the purpose of argument, that either the bankrupt or his wife, Mrs. Mayhew, had prior to both the petition and adjudication in bankruptcy, and the conveyance to Wayman, duly and regularly filed and recorded a declaration of homestead as provided by the state law. In this situation there could be no question but that at the time of the conveyance and at the time of the adjudication, there was an exemption right. What would have been the effect if the homestead so secured had been conveyed prior to the petition and adjudication in bankruptcy, either as a preference or in fraud of creditors, or as a part of the general assignment for the benefit of creditors?

Sections 67, Sub. e, and 70, of the Bankruptcy Act, provide respectively as follows:

> "That all conveyances, transfers, assignments, or incumbrances of his property, or any part thereof, made or given by a person ad-

judged a bankrupt under the provisions of this act subsequent to the passage of this act and within four months prior to the filing of the petition, with the intent and purpose on his part to hinder, delay, or defraud his creditors, or any of them, shall be *null and void,* as against the creditors of such debtor, except as to purchasers in good faith and for a present fair consideration; and all property of the debtor conveyed, transferred, assigned or encumbered as aforesaid shall, if he be adjudged a bankrupt, *and the same is not exempt from execution and liability for debts by the law of his domicile,* be and remain a part of the assets and estate of the bankrupt and shall pass to his said trustee, whose duty it shall be to recover and reclaim the same by legal proceedings or otherwise for the benefit of his creditors."

"The trustee of the estate of a bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, *except in so far as it is to property which is exempt,* to all (1) documents relating to his property; (2) interests in patents, patent rights, copyrights, and trade-marks; (3) powers which he might have exercised for his own benefit, but not those which he might have exercised for some other person; (4) *property transferred by him in fraud of his creditors;* (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him."

Section 60, Sub. b, provides as follows:

> "If a bankrupt shall have procured or suffered a judgment to be entered against him in favor of any person or have made a transfer of any of his property, and if, at the time of the transfer, or of the entry of the judgment, or of the recording or registering of the transfer if by law recording or registering thereof is required, and being within four months before the filing of the petition in bankruptcy or after the filing thereof and before the adjudication, the bankrupt be insolvent and the judgment or transfer then operate as a preference, and the person receiving it or to be benefited thereby, or his agent acting therein, shall then have reasonable cause to believe that the enforcement of such judgment or transfer would effect a preference, it shall be *voidable* by the trustee and he may recover the property or its value from such person."

The only reference to a general assignment for the benefit of creditors is contained in Section 3 wherein such an assignment is enumerated as one of the acts of bankruptcy.

There are two possible constructions of Section 67e and Section 70 of the Bankruptcy Act arising from the inclusion of the italicized words. (a) It may well be held that the intent of Section 67e, in view of these words, is *to expressly permit a bankrupt to claim an exemption out of property that has been fraudulently transferred.* This construction is consistent with the express provision that such transfers are *null and void.* If null and void and no title passes, the bankrupt obviously had title at the date

of adjudication, and his exemption right, therefore, could not be affected.

In view of the fact that by Section 60b, a preferential transfer is made only *voidable,* and that such preferential transfers are not included either by way of intendment or by express terms in Secs. 67 and 70, it would seem that the right accorded to the bankrupt by those latter sections in the case of a fraudulent transfer *is denied in the case of a preferential transfer.* The same reasons are applicable to the case of a general assignment for the benefit of creditors, which likewise is only voidable (Remington on Bankruptcy, Sec. 1606, page 777, and cases cited), and is not included in the provisions of Section 67e or Section 70. In the case of transfers of these two latter kinds, therefore, it would shrdlu pun punpun logically, that the bankrupt is, by making such transfers, precluded from subsequently claiming his exemptions.

This view of the construction and bearing of the italicized words in Section 67e and Section 70 is adopted by Mr. Remington as the proper one.

> "Section 67e by its express provisions sets aside fraudulent (*although not preferential*) transfers as to the bankrupt as well as to the creditors, and *permits the bankrupt to have exemptions from the property so recovered;* so the case of In re Codington could not lay down the correct rule as to fraudulently transferred property, *although it might do so as to property merely preferentially transferred.*"
>
> Vol. 1, Sec. 1095, page 620.

If this construction of the sections in question is the proper one, it is obvious that the distinction made by this Court between preferential transfers and transfers in fraud of creditors on the one hand, and general assignments for the benefit of creditors on the other, is untenable. The distinction to be made is not that suggested, but between fraudulent transfers on the one hand and preferential and transfers for the benefit of creditors on the other. In the case of fraudulent transfers, by the direct provisions of the Bankruptcy Act, the bankrupt is not precluded from claiming his exemptions. In the case of a preferential transfer and transfers for the benefit of creditors, on the other hand, by the necessary application of the provisions of the Act, he is precluded.

(b) There is another possible construction, however, of Section 67e and Section 70, arising from the inclusion of the italicized words. Congress may have intended only to provide that the transfer of property in fraud of creditors where such property consisted of *both exempt and non-exempt property,* should be null and void as to the latter, but not as to the former; that the trustee could recover property so transferred, *except such as was exempt,* and that he would be vested with title as of the date of adjudication to all of the property so transferred *except such as was exempt.* This construction, and it is probably the correct one, would necessarily lead to

this result. The bankrupt, having voluntarily conveyed exempt property, cannot recover it back from his transferee, and the trustee, by reason of the fact that he is not entitled to the exempt property, is likewise precluded. In other words, *where exempt property is fraudulently transferred the property is taken out of the control of both the bankrupt and the trustee.*

If this be the proper construction of Section 67e and Section 70, it is obvious that the principle is also applicable to preferential transfers and transfers for the benefit of creditors. In these cases, as well as in the case of a fraudulent transfer, so much of the property transferred as was exempt, would necessarily be beyond the control of the trustee, since title had never vested in him, and would likewise be beyond the control of the bankrupt. This construction has, as a matter of fact, been adopted with reference to preferential transfers in several cases.

> "A mortgage constituting an unlawful preference where is includes both exempt and non-exempt property, is only voidable by the trustee as to non-exempt property and remains a valid mortgage as to the exempt property."
>
> In re Bailey, 176 Fed. 990.

> "A transfer of a homestead exemption is not a preference, since it is not subject to the demands of creditors."
>
> Mills v. Fisher & Co., 159 Fed. 897.

> "If a part of the property transferred by the bankrupt to the bank was exempt, or the

> proceeds of exempt property, under the Iowa Statute, the creditors generally would have no right thereupon, nor the trustee, to recover the same for their benefit."
>
> Vitzthum v. Large, 162 Fed. 685.

On the second theory just discussed, upon what possible ground would a bankrupt be entitled to reclaim in bankruptcy proceedings, as exempt, property which he had theretofore transferred? It is obvious that if he is entitled to do so it cannot be on the theory "that he has no right to extend his claim over that to which he has no title except through the intervention and instrumentality of the trustee", as suggested by the Court, *for the simple reason that the trustee could not intervene or recover the exempt property by action or otherwise.* If, then, the transferee for some reason sufficient to himself, voluntarily waives his own right to the exempt property which has been transferred to him and which he can successfully, if he desires, hold as against both the bankrupt and the trustee, and transfers and surrenders it to the trustee to be administered with the assets of the bankrupt for the benefit of all the creditors, on what possible ground can the bankrupt urge any claim to it? The bankrupt has voluntarily waived all claims against it by his conveyance, and the trustee receives it, *not by virtue of the Bankruptcy Act,* but solely by reason of the voluntary act of the transferee. It

would seem that the property under such circumstances has entirely lost its character as exempt, and that the bankrupt has lost his right to claim it as such.

Under any possible construction, therefore, of Section 67e and Section 70 of the Bankruptcy Act, it is apparent that regardless of the "motive" that may have actuated the bankrupt, he has effectively precluded himself by a voluntary conveyance whether fraudulent or preferential, or as an assignment for the benefit of creditors, from subsequently claiming the property as exempt. The reason is that he has utterly transferred the title out of himself and that when it comes into the trustee's hands it comes not through the operation of the Bankruptcy Act, but through the voluntary act of the transferee. We can see no escape from this conclusion.

What has just been said has been on the assumption that the homestead right actually existed at the date of the transfer to Willard O. Wayman. When it is considered that, as a matter of fact, there had been no declaration of homestead filed at that date, and hence no homestead right, it would seem to be doubly true that the bankrupt could not thereafter *create a homestead exemption while the property was in the hands of the transferee,* and subsequently claim it when voluntarily surrendered to the trustee.

In conclusion it is submitted that the reasoning of the Court on the two fundamental questions decided by it does not bear analysis, and has no support in any of the provisions of the Bankruptcy Act. We fully appreciate that it is the desire of the Court to be as liberal as possible in the matter of granting exemptions, but this liberality should be exercised within the limits prescribed by the Bankruptcy Act. Every consideration, we submit, urges for a further and more careful consideration of the questions involved in this case.

If, for any reason, the Court feels that its position would be the same even were a rehearing granted, we would suggest that at least it be granted to the end that the questions involved may be certified to the Supreme Court for its instruction. The Federal Courts seem to be in hopeless confusion on the questions involved and the opinion of the majority in the present case is in direct conflict with the opinion of a present member of the Supreme Court. It is desirable that important and fundamental questions arising from the Bankruptcy Act should be finally determined and adjudicated to the end that the Act may have a uniform application.

Dated, San Francisco,
November 9, 1914.

Respectfully submitted,

R. H. Cross,
Attorney for Petitioner.

Certificate of Counsel.

I hereby certify that I am of counsel for petitioner in the above entitled cause and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact and that said petition is not interposed for delay.

R. H. Cross,
Attorney for Petitioner.